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Notes on the Revenue Act of 1942

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The Revenue Act of 1942

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The provisions of the Revenue Act of 1942 are in the form of Amendments to the Internal Revenue Code. Except in the case of specific exceptions, they apply to taxable years beginning after December 31, 1941.

This article endeavors to set forth in condensed form the more important changes in the Code which resulted from the amendments made by the 1942 Act.

Corporation Tax Rates and Computation

Under prior law, the excess profits tax was first computed at graduated rates on the "adjusted excess profits net income," representing the "excess profits net income" less the sum of the specific exemption of $5,000, the excess profits credit, and the "unused excess profits credit" of prior years. The excess profits tax as so computed was allowed as a deduction from net income in computing the normal tax and surtax.

Under the new law, the portion of the income which is subject to excess profits tax is not subject to normal tax or surtax. The excess profits tax is a flat 90 per cent of the adjusted excess profits net income (subject to the limitation indicated below) with a postwar refund of 10 per cent of the excess profits tax. The normal tax and surtax are computed on the remainder of the income, after deducting the income which is subject to excess profits tax. The normal tax rate is 24 per cent where the normal-tax net income exceeds $50,000, and the surtax rate is 16 per cent where the surtax net income exceeds $50,000. The combined normal tax, surtax and excess profits tax cannot exceed 80 per cent of the surtax net income.

The corporation taxes are computed as follows, using illustrative figures:

Table I—EXCESS PROFITS TAX

1.	*Excess profits net income* (as defined in section 711)		$ 900,000
	Less:		
2.	Specific exemption	$ 5,000	
3.	Excess profits credit (based on invested capital or prewar base period earnings)	500,000	
4.	Unused excess profits credit (from prior years)	100,000	
5.			605,000
6.	*Adjusted excess profits net income*		$ 295,000
7.	*Excess profits tax* (90 per cent of item 6)		$ 265,500

Table II—NORMAL TAX

1.	*Net income*, as defined in the statute (gross income, less allowable deductions)	$1,000,000
2.	Less, Interest on partially exempt federal securities.	25,000
3.	*Adjusted net income*	975,000
4.	Less, Adjusted excess profits net income (item 6 of Table I above)	295,000
5.		680,000
6.	Less, Dividends received credit (85 per cent of domestic dividends received, but not in excess of 85 per cent of line 5)	50,000
7.	*Normal tax net income*	$ 630,000
8.	*Normal tax* (24 per cent of item 7)	$ 151,200

For computations with normal-tax net incomes of not more than $25,000, the normal tax rates are the same as under prior law:

Normal-Tax Net Income	*Rates of Tax*	*Normal Tax*
0—$ 5,000	15 per cent	$ 750
$ 5,000—$20,000	17 Do	2,550
$20,000—$25,000	19 Do	950
Normal tax on $25,000		$4,250

Where the normal-tax net income exceeds $25,000 but does not exceed $50,000, the normal tax is $4,250 plus 31 per cent of the normal-tax net income in excess of $25,000.

Table III—SURTAX

1.	*Net income*, as defined in the statute (which includes partially exempt interest)		$1,000,000
2.	Less, Adjusted excess profits net income (item 6 of Table I above)		295,000
3.			705,000
4.	Less: Dividends received credit (85 per cent of domestic dividends received, excluding dividends received on public utility preferred stocks, but not in excess of 85 per cent of line 3)	$50,000	
5.	In the case of a public utility, dividends paid on cumulative preferred stock issued prior to October 1, 1942	60,000	110,000
6.	*Corporation surtax net income*		$ 595,000
7.	*Surtax* (16 per cent of item 6)		$ 95,200

When the corporation surtax net income does not exceed $25,000, the surtax rate is 10 per cent. When the corporation surtax net income exceeds $25,000 but does not exceed $50,000, the surtax is $2,500 plus 22 per cent of the amount of surtax net income over $25,000.

80 Per Cent Over-All Limitation

As previously noted, the combined normal tax, surtax and excess profits tax is limited to 80 per cent of the surtax net income. The limitation operates to reduce the excess profits tax that otherwise would be payable. In other words, the excess profits tax is the lesser of: (a) 90 per cent of the adjusted excess profits net income, or (b) an amount which when added to the normal tax and surtax equals 80 per cent of the corporation surtax net income. For this purpose the corporation surtax net income is computed without reduction for the adjusted excess profits net income (item 2 in Table III). The penalty tax imposed by section 102 on earnings accumulated to avoid surtax on shareholders is not included in the taxes subject to the 80 per cent limitation.

Using the figures previously employed for illustration, the corporation surtax net income (item 6, Table III) amounts to $595,000. Adding back the adjusted excess profits net income (item 2, Table III) amounting to $295,000, the base amount for computing the 80 per cent limitation would be $890,000. The excess profits tax cannot exceed the difference between (a) $712,000 (80 per cent of the above stated $890,000) and (b) the sum of the normal tax and surtax.

Assume that the total of the specific exemption, the excess profits credit and the unused excess profits credit were $100,000, instead of the $605,000 shown on line 5 of Table I. The adjusted excess profits net income would be $800,000. The normal tax would be $30,000, or 24 per cent of [$1,000,000 − ($25,000 + $800,000 + $50,000)]. The surtax would be $14,400, or 16 per cent of [$1,000,000 − ($800,000 + $110,000)]. The excess profits tax would be computed as follows:

Limitation, 80 per cent of corporation surtax net income before deducting adjusted excess profits net income		$712,000
Less:		
Normal tax	$30,000	
Surtax	14,400	44,400
Amount of excess profits tax		$667,600

If it were not for the limitation the excess profits tax on the last assumption would be $720,000 [90 per cent of ($900,000 — $100,000)].

Deduction of Adjusted Excess Profits Net Income

As indicated in Table II and Table III, the adjusted excess profits net income is deducted in arriving at normal-tax net income and corporation surtax net income. In some cases the excess profits tax is not measured by the entire adjusted excess profits net income. In such cases, in lieu of deducting the adjusted excess profits net income there is allowed as a deduction the amount of which the excess profits tax is 90 per cent, that is, 100/90ths of the excess profits tax.

Such cases are (1) where there are abnormalities in income of the taxable year under section 721; (2) corporations completing contracts under the Merchant Marine Act (section 726); (3) corporations engaged in mining strategic minerals (section 731); and corporations with income from long-term contracts [section 736 (b)]. In computing 100/90ths of the excess profits tax, such excess profits tax is before applying the foreign tax credit or the 80 per cent overall limitation.

Postwar Refund of Excess Profits Tax

The Secretary of the Treasury is directed to establish a credit to the account of each excess profits taxpayer with a taxable year ending on or after July 31, 1942, of an amount equal to 10 per cent of the excess profits tax, and within three months after the tax is paid to issue to the taxpayer bonds in such amount. In the case of a fiscal year beginning in 1941 and ending after June 30, 1942, the credit is 10 per cent of the difference between the excess profits tax imposed for such year and what the excess profits tax would have been for such year under the old law.

The bonds bear no interest, and cannot be transferred, pledged or assigned until the cessation of hostilities in the present war. They mature on a sliding scale. Bonds purchased with a credit for 1942 mature on December 31 of the second calendar year beginning after cessation of hostilities. The proceeds of the bonds need not be included in taxable income.

Strangely enough, when the total of excess profits tax, normal tax and surtax passes the 80 per cent limitation point, it becomes advantageous from the postwar credit standpoint for the excess profits tax to be as large as possible. Hence the lower the excess profits credit, and the higher the excess profits net income in relation to the surtax net income, the better off the corporation is. The postwar refund is based only on the excess profits tax. The greater the excess profits tax, the greater the postwar

refund, whereas the total tax (being limited to 80 per cent) remains unchanged. The saving is 4 per cent (10 per cent of 40 per cent) of the decrease in the excess profits credit or the increase in the excess profits net income.

However, in order to secure this advantage, taxpayers cannot use the lower of the income credit or the invested capital credit. The new law requires that the credit be used which results in the lower excess profits tax, which would be before the postwar refund. The privilege of disclaiming one of the credits is eliminated retroactively.

If the adjusted excess profits net income is high enough with relation to the normal tax and surtax net income, a company may pay no normal or surtax, the entire 80 per cent representing excess profits tax.

Credit for Debt Retirement

If the taxpayer so elects, he may in his return deduct as a credit against the excess profits tax 40 per cent of the amounts paid on the principal of indebtedness evidenced by a bond, note, etc., up to 10 per cent of the excess profits tax for the taxable year. Any such credit claimed reduces the amount of credit available for postwar refund bonds.

No credit is allowed for a taxable year beginning in 1941 or ended before September 1, 1942. In the case of a taxable year beginning in 1942 prior to September 2 and ending after September 1, 1942, the credit is limited to 40 per cent of the amount by which the debt at September 1, 1942 exceeds the debt at the close of the taxable year. In the case of later taxable years the limit is 40 per cent of the amount by which the smallest amount of debt during the period beginning September 1, 1942 and ending with the close of the preceding taxable year exceeds the debt as of the close of the later taxable year.

Corporations With Fiscal Years

Corporations with fiscal years ended on or before June 30, 1942, are not affected by the tax rates of the new law. In the case of corporations with a fiscal year beginning in 1941 and ending after June 30, 1942, a tentative excess profits tax (A) is computed under the old law. Another tentative excess profits tax (B) is computed at the rates in the new law. The excess profits tax is that portion of (A) which the number of days in such taxable year before July 1, 1942 bears to the total number of days in the taxable year plus that portion of (B) which the number of days in such taxable year after June 30, 1942 bears to the total number of days in the taxable year.

Similarly, in the case of the normal tax and surtax, the tax is that portion of a tentative tax computed under the old law which the days before July 1, 1942 bear to the total days in the taxable year and

that portion of a tentative tax computed at the new rates which the days after June 30, 1942 bear to the total days in the taxable year.

In determining the tentative excess profits tax, normal tax and surtax at the new rates, the new method of determining the portion of the income subject to each tax is used, except that the deduction for dividends on public utility preferred stocks is not allowed in computing the surtax. Otherwise, both the excess profits credit and the net income are computed under the old law for the purpose of the tentative tax at both new and old rates. For example, the new limitations on capital losses will not apply to any fiscal year ended in 1942, if such year began in 1941.

Returns for Fractional Part of Year

When a corporation changes its fiscal year it must file a return for a short period to effectuate the change. The income for the short period must be placed on an annual basis.

The new law provides that, if the taxpayer establishes what is the net income for the twelve months beginning with the first day of the short period, the tax for the short period shall be reduced to an amount which is such part of the tax computed on the net income for such twelve-month period as (a) the net income for the short period is of (b) the net income for the twelve-month period.

The tax for the short period cannot be less than the tax would be without placing the income on an annual basis.

In the case of a corporation which has disposed of substantially all its assets, the twelve-month period above referred to ends with the last day of the short period instead of beginning with the first day of that period.

Relief must be sought by way of claim for refund. The income need not be placed on an annual basis in computing any of the taxes where the dividends paid credit is a factor. The amendment regarding returns for fractional periods is a commendable correction of a serious inequity in prior law.

Western Hemisphere Trade Corporations

Western Hemisphere Trade Corporations are exempt from the corporation surtax. They are defined as domestic corporations all of whose business is done in North, Central, or South America, the West Indies or Newfoundland if (a) 95 per cent or more of the gross income for the three years preceding the close of the taxable year was derived without the United States, and (b) 90 per cent or more of its gross income for such period was derived from the active conduct of a trade or business. Such corpora-

tions are already exempt from excess profits tax.

FOREIGN TAX CREDIT

Under prior law a taxpayer had to make an irrevocable election in its tax return to treat foreign income taxes as a deduction from income or as a credit against the tax. For taxable years beginning after December 31, 1940, the election may be made at any time within the statutory period for filing refund claims. The change is a very desirable one because in some cases a taxpayer does not know which method is most advantageous until the Treasury has audited the return.

For taxable years beginning after December 31, 1941, credit is allowed for income taxes paid by a subsidiary of a foreign subsidiary, and credit is allowed for taxes paid in lieu of income tax otherwise generally imposed by any foreign country or by any possession of the United States.

The limiting ratio on the credit for foreign taxes against the normal tax and surtax is that proportion of the tax which the net income from foreign sources bears to the sum of the normal-tax net income and the credit for adjusted excess profits net income. Using the figures in Table II at the beginning of this article such latter sum would be $630,000 plus $295,000 or $925,000.

Corporate Income Determination

$25,000 SALARY LIMITATION

Under the regulations which were promulgated by the Economic Stabilization Director on October 27, 1942, pursuant to the Act of October 2, 1942, an employer may not pay a salary which, after reduction by the Federal income taxes on the amount of such salary, would exceed $25,000. The Federal income taxes on the salary are computed on the assumption that the salary represents the entire net income of the employee after the allowance of applicable credits. If an employee has substantial other income, the result will be that he will retain much less than $25,000 of his salary. The maximum salary for 1943 under the regulations will be about $67,000, excepting in those cases where it may be increased by items of the kind mentioned in the next succeeding paragraph.

If an employee establishes that his income from all sources is insufficient to meet customary charitable contributions, etc., without undue hardship, he may be paid an additional amount to meet such payments. An additional amount may be paid to an employee who establishes that, after resorting to his income from all sources, he is unable, without disposing of assets at a substantial loss resulting in undue hardship, to meet the following payments: (1) Life insurance

premiums on policies in force on October 3, 1942; (2) required payments on fixed obligations in effect on October 3, 1942; and (3) Federal income taxes for prior years, not including taxes on the limited salary allowance.

Though the limitations above described apply to salary paid or accrued after December 31, 1942, no amount may be paid or accrued after October 27, 1942 and before January 1, 1943, if the total salary paid, authorized, accrued or received for the calendar year 1942 exceeds the prescribed limit (which in 1942, because of the victory tax not becoming effective until 1943, would be only approximately $54,000) and also exceeds the total salary for the calendar year 1941. However, an amendment to the regulations on November 5, 1942, suspends the limitation for 1942 in any case in which the compensation is paid pursuant to a bona fide contract in effect on October 3, 1942.

If an employer pays a higher salary than allowed under the regulations, the entire salary will be disallowed as a deduction for tax purposes. This provision of the regulations applies to salaries generally and not only to those exceeding $25,000.

The $25,000 limitation was a suggestion by the president of the C. I. O. and did not originate in Congress. On the contrary, Chairman George of the Senate Finance Committee was quoted as saying that the $25,000 limitation would cause the Treasury to lose revenue, would raise administrative costs, and would penalize the man who works for his income.

Pension Trusts, Annuity Plans, Etc.

The new law places serious restrictions on deductions for payments made under stock bonus, pension, profit sharing or annuity plans, whether in the form of trusts or in the form of payments to insurance companies. Unless the requirements of the Act as to the plan being nondiscriminatory, etc., are met, the employees are immediately taxable if their interest is nonforfeitable, even though they may not receive benefits until many years later. If the requirements of the Act are not met and the interest of the employees is forfeitable, the corporation is allowed no deduction. There are also further restrictions on the portion of contributions that may be deductible by the employer in each taxable year. Corporations can no longer deduct in one year unlimited lump sum payments to insurance companies for annuities covering past service benefits.

Consolidated Returns

If an affiliated group of corporations makes a consolidated excess profits tax return it must make a consolidated return for normal and surtax purposes and the surtax will

be increased by 2 per cent of the consolidated corporation surtax net income. The requirement of consolidated normal and surtax returns is commendable, but there is no justification for the 2 per cent penalty. The new provision will benefit corporate groups if some of the members have net losses, but there may be cases where the benefit for income tax purposes would not be sufficient to warrant assuming the additional 2 per cent. Since, however, both excess profits and income taxes are involved, it will require considerable computation in some cases to determine whether consolidated or separate returns would be the more advantageous.

Last-In First-Out Inventories

Under prior law if a taxpayer wished to use the last-in first-out inventory method, all interim financial statements had to be prepared on the last-in first-out method. In many cases this was entirely impracticable. The new law eliminates this requirement as to interim statements, retroactively to taxable years beginning after December 31, 1938.

Many corporations which adopted the last-in first-out inventory method have found that as a result of war conditions beyond their control they have been unable to keep an inventory of normal size and consequently the inventory which was frozen at a comparatively low cost will be largely disposed of in 1942, when the profit will be taxable at the new high rates.

The new law purports to grant relief to such taxpayers for taxable years beginning after December 31, 1941 and prior to the end of the war, if the taxpayer so elects in its return, and if the closing inventory of a subsequent year ending not more than three years after the war reflects a replacement in whole or in part of the goods so liquidated. The relief granted is a retroactive adjustment decreasing net income by the excess of the aggregate replacement cost of the goods over the aggregate cost reflected in the opening inventory of the year of the involuntary liquidation, but if the replacement cost is less than such inventory cost the difference must be added to such net income.

The corporation must currently pay its full tax and secure a refund after the replacement of the goods.

It is entirely problematical whether the new provision will actually afford relief in any particular case, since the eventual replacement price cannot be known.

Amortization of Emergency Facilities

Prior to amendment the amortization deduction was limited to emergency facilities constructed or acquired by corporations after June 10, 1940. The new law extends to individuals, partnerships and estates and trusts the same privilege of claiming amortization of emergency

facilities and the date of the beginning of the emergency has been changed to January 1, 1940.

The term "emergency facility" has been broadened to include facilities acquired or completed (A) by corporations after December 31, 1939 and before June 11, 1940, and (B) by persons other than corporations after December 31, 1939.

Applications for Certificates of Necessity must be filed by corporations within six months after October 21, 1942 (date of passage of 1942 Act) in the case of emergency facilities acquired or completed after December 31, 1939 and before June 11, 1940. In the case of emergency facilities completed or acquired after December 31, 1939 by persons other than corporations the application must be filed before the expiration of six months after the beginning of such construction, etc., or within six months after October 21, 1942, whichever is later.

As to emergency facilities completed or acquired (1) after December 31, 1939 and before June 11, 1940 by corporations or (2) after December 31, 1939 and before January 1, 1942 by a person other than a corporation, the taxpayer must advise the Commissioner of his election to take amortization within six months after October 21, 1942.

No amortization deduction will be allowed unless the Certificate of Necessity is made (1) within twelve months after October 21, 1942 in the case of facilities acquired or completed by corporations after December 31, 1939 and before June 11, 1940 or (2) within nine months after the last date an application may be filed or within twelve months after October 21, 1942 whichever is later in the case of facilities completed or acquired by persons other than corporations after December 31, 1939 and before January 1, 1943.

In order to protect taxpayers who might begin construction on facilities during the emergency period but not complete them when the war terminates, an amendment permits the taxpayer to use an amortization period beginning with the month in which the construction was begun and ending with the month within which the emergency period ends or the facility ceased to be necessary in the interest of national defense.

Provision is made for the credit or refund of income, declared value excess-profits and excess profits taxes which would not have been paid had the amortization provisions in the new Act been enacted on October 8, 1940 (date of Second Revenue Act of 1940).

Depletion

For taxable years beginning after December 31, 1941, in the case of taxpayers entitled to use percentage depletion, the depletion allowance will be the greater of (1) such

percentage depletion or (2) depletion computed on cost or March 1, 1913 value. No election is required. Percentage depletion at 15 per cent for fluorspar, ball and sagger clay and rock asphalt mines has been added to the provisions for percentage depletion of natural deposits contained in earlier laws.

Capital Gains and Losses

The dividing line between long-term capital gains and losses and short-term capital gains and losses is reduced from eighteen months to six months. All capital gains, whether long or short-term are considered together, as are all capital losses, and capital losses are deductible only from capital gains. Short-term capital losses may be deducted from long-term capital gains and vice versa.

If a corporation has a net long-term capital gain in excess of any short-term capital loss, the normal tax, surtax and personal holding company surtax may not exceed 25 per cent of such excess. This is the first time there has been a tax limitation on corporate capital gains. Long-term capital gains and losses are excluded in computing excess profits net income for the taxable year and base period years (similar to prior law), but the dividing line between long- and short-term is made six months, as in the case of normal tax and surtax.

The excess of capital losses (whether short-term or long-term) over capital gains (whether short-term or long-term) is called a "net capital loss." A net capital loss sustained in any taxable year beginning after December 31, 1941 may be treated as a short-term capital loss in each of the five succeeding taxable years, and as such may be deducted from any excess of capital gains over capital losses (whether short-term or long-term) until used up. If there are carry-overs for more than one year, the older carry-over is to be used up before the later carry-over.

In order that a corporation may not lose any benefits of prior law, a net short-term capital loss of the last taxable year beginning in 1941 (not in excess of the net income of such year) may be treated as a short-term capital loss in the succeeding year to the extent of the net short-term capital gain of the succeeding year.

The holding period of stock or securities acquired from a corporation by the exercise of rights will begin with the date the rights are exercised.

When a bank has sustained net losses on the sale of securities described in the statute, such losses are treated as ordinary losses rather than capital losses.

Under prior law any gain realized from a distribution in partial liquidation, such as the retirement of preferred stock, was a short-term capital gain regardless of the period

the stock was held. The new law eliminates this arbitrary restriction and the classification of the capital gain will depend on the holding period of the stock.

Real Property; Involuntary Conversions; Etc. Under prior law depreciable property used in the trade or business was excluded from the definition of capital assets. The new law excludes all real property used in the trade or business.

However, if the taxpayer derives gains from (1) the sale or exchange of depreciable or real property used in the trade or business held for more than six months (not held for sale to customers) plus (2) the involuntary conversion of such assets and capital assets held more than six months, and the total of such gains exceeds the losses of the same kind, such gains and losses are treated as long-term capital gains. If there is a net loss from the above sources the loss is treated as an ordinary loss.

Prior law recognized no gain or loss when property was involuntarily converted into property similar or related in service or use, or into money which was used to acquire such property. Under the new law gain is not recognized, but any loss is recognized.

Stock and Bond Losses on Securities of Affiliated Companies. Under prior law if shares of stock in a corporation or rights to acquire such shares became worthless the loss was a capital loss. Similarly, if bonds, notes, etc., issued by a corporation with interest coupons or in registered form became worthless (in the case of a taxpayer other than a bank) the loss was a capital loss rather than a bad debt.

The new law excludes from the capital loss category, but allows as ordinary losses, stock or securities of any corporation affiliated with the taxpayer except that no *partial* bad debt deduction is allowable with respect to such securities.

A corporation is deemed to be affiliated with the taxpayer for this purpose only if (1) at least 95 per cent of each class of its stock is owned directly by the taxpayer; (2) more than 90 per cent of the aggregate of its gross incomes for all taxable years was derived from sources other than royalties, rents, dividends, interest or annuities or gains from the sales or exchange of stock and securities; and (3) the taxpayer is a domestic corporation. It is not necessary that the corporation the stock or securities of which becomes worthless be a domestic corporation.

War Losses

Because of the uncertainties as to when war losses are sustained, the new law provides rules to cover deductions for property destroyed or seized on or after December 7, 1941, in the course of military or naval operations.

Property within an enemy coun-

try or within an area under the control of an enemy country on the date the United States declared war on such country will be deemed to have been destroyed or seized on the date war with such country was declared by the United States.

In the case of property within an area which comes under control of an enemy country after the United States declared war on such country, the property will be deemed to be destroyed or seized on the date the enemy gains control of the area. Since in some cases this date will be uncertain, the taxpayer may elect to deduct the loss at any time after the latest date on which the United States or a friendly country had complete control of the area and before the earliest date on which the enemy gained complete control, such dates to be determined by the Commissioner.

In the case of an interest in or with respect to property referred to above, including stock or securities of a corporation owning such property, the interest will be deemed to have been destroyed or seized when the last property to which the interest relates would be deemed seized or destroyed under the above rules. In the case of corporate stock or securities, the losses will be ordinary losses and not capital losses, despite the general provisions which treat such losses as capital losses. The possibility of recovery of the property or of compensation for the destruction or seizure may be disregarded, except where there is insurance or similar indemnity.

Any recoveries of war losses must be included in taxable income to the extent that the war losses resulted in a reduction of any income tax of the taxpayer.

The war loss amendments are applicable to taxable years beginning after December 31, 1940, but no loss can be claimed before December 7, 1941 with respect to the property referred to in the amendments.

Bad Debts

The requirement that bad debts be charged off is eliminated retroactively to taxable years beginning after December 31, 1938.

The period of limitation for filing claims for refund involving deductions for bad debts or "securities" becoming worthless is made seven years from the due date of the return, instead of three years.

There have been many cases where a taxpayer charged off a bad debt in one year and the Treasury disallowed the deduction on the ground that the debt became worthless in a prior year. Refund for the prior year was then denied, either because the debt had not been charged off or because the statute of limitations had run. The amendment will relieve this situation.

Recovery of Bad Debts and Prior Taxes

To resolve conflicting decisions, the new law provides that there be

excluded from gross income recoveries of bad debts and taxes to the extent that the original deduction of the bad debts and taxes did not reduce the income tax liability for any prior taxable year. The amendment also covers interest on delinquent taxes and is retroactive to all prior Revenue Acts.

Recovery of Unconstitutional Federal Taxes

In the case of any recoveries of unconstitutional federal taxes in taxable years beginning after December 31, 1940 (such as processing taxes), the taxpayer may elect to exclude them from taxable income if he pays the additional tax that would be due for the prior year because of eliminating the unconstitutional tax as a deduction, even though the statute of limitations has run for the prior year. This amendment disposes of the possibility that a company securing a process tax refund might have to pay a much higher rate of tax on the refund than was saved in the year the processing taxes were paid.

Two-Year Carry-Back of Net Operating Losses

The prior law permitted a net operating loss to be carried forward to the two succeeding years. The new law allows a net operating loss in any taxable year beginning after December 31, 1941 to be carried back to the two preceding years, except that a loss cannot be carried back to any taxable year beginning before January 1, 1941.

A net operating loss for a taxable year beginning after December 31, 1941 is first carried back to the two preceding years (not including a taxable year beginning before January 1, 1941) and any excess over the sum of the income of the two preceding years may be carried forward two years. If a corporation has a large net operating loss for 1943, for example, such loss will be applied first to 1941, then to 1942, then to 1944 and finally to 1945.

Amortization of Bond Premium

Heretofore, the issuer of a bond was permitted to amortize the bond premium or discount but the bondholder could not. The premium was a capital loss when the bond was redeemed. The new law allows the bondholder to amortize the premium only, but does not apply to bond dealers.

Amortization is mandatory with respect to fully tax-exempt bonds in the case of all taxpayers, but such amortization is not deductible from income. It merely reduces the tax basis of the bond. For this reason some taxpayers may decide to sell now such bonds which were purchased at a premium and secure a capital loss.

Amortization is elective if the bond interest is fully taxable. If the bond interest is partially exempt, amortization is mandatory in the

case of corporations and elective in the case of other taxpayers.

Exclusion of Income from Discharged Indebtedness

Under prior law no income was realized by a corporation from the discharge of indebtedness evidenced by a security, if the corporation was in unsound financial condition, but the corporation's tax basis of its assets was reduced by the exempted income. The new law eliminates the requirement that the corporation be in unsound financial condition, if the corporation consents to the reduction of the tax basis of the assets, and extends the privilege to all taxable years beginning after December 31, 1941 but before January 1, 1946.

In the case of railroad corporations, as defined in Section 77 M of the National Bankruptcy Act, as amended, there is excluded income realized by reason of a modification in or a cancellation of indebtedness pursuant to a court order, without reduction of the tax basis of assets.

Improvements by Lessee

To overcome the effect of *Helvering* v. *Bruun* (309 U. S. 461) there is excluded from the gross income of a lessor the income derived by a lessor of real property upon the termination of a lease attributable to improvements made by the lessee, and such inprovements may not be included in the tax basis of the assets to the lessor. The troublesome problem of valuing such improvements is accordingly eliminated.

Excess Profits

Invested Capital Credit

The excess profits credit based on invested capital will be computed at the following rates:

On portion of Invested Capital	*Rate of Credit*
Not over $5,000,000	8%
$ 5,000,000—$10,000,000	7%
$10,000,000—$200,000,000	6%
Over $200,000,000	5%

Excess Output of Mining and Timber Operations

As an incentive to mining and timber operations, the new law excludes from excess profits net income certain income from excess output of mines and timber blocks, and bonus payments made to producers of minerals or timber by agencies of the government. The excess output exempted from excess profits tax is determined by the relation of the output in the taxable years to that of the "base period" beginning after December 31, 1935, and before January 1, 1940.

Two-Year Carry-Back of Unused Excess Profits Credit

Prior law permitted a two-year carry forward of an unused excess profits credit (the excess of the excess profits credit over the excess profits net income). The new law permits in addition a two-year

carry-back, beginning with the unused excess profits credit for a taxable year beginning after December 31, 1941. There can be no carry-back to any taxable year beginning prior to January 1, 1941. The unused credit is first carried back, and any excess over the adjusted excess profits net income for the two preceding years may be carried forward to the two succeeding years.

An unused excess profits credit for a fractional part of a year is reduced to such part thereof as the number of days in the fractional period is of the number of days in the twelve months ending with the close of the taxable year.

Base Period Net Income of Lowest Year in Base Period

Under prior law in computing the average base period net income under the general average rule a deficit year could be omitted, or if there was a deficit in more than one year the year with the greatest deficit could be omitted. The new law is much more equitable in that it permits the exclusion of any one year whether or not a deficit year and the substitution therefor of 75 per cent of the average income of the other years, reduced by deficits. The new rule will not apply if a taxpayer elects to use the growth provision, relating to cases where there are increased earnings in the last half of the base period.

Invested Capital in Tax-Free Intercorporate Liquidations

Under prior law when a subsidiary was liquidated in a tax-free liquidation under section 112(b)(6), there was added to the invested capital of the parent company the excess of the tax basis of the subsidiary's assets over the tax basis of the parent company's investment in the stock of the subsidiary. If the tax basis of the assets was less than the tax basis of the stock the difference reduced invested capital only to the extent of the earnings and profits of the parent.

The new law draws a distinction between cases where the stock of the subsidiary has a "cost" basis in the hands of the parent and cases where such stock does not have a "cost" basis. The law does not define "cost" basis, leaving that to the regulations. Presumably the Commissioner will issue regulations similar to the consolidated returns regulations, and define a "cost" basis as a basis determined without reference to the basis in the hands of a transferor, with various exceptions.

When the stock of the subsidiary has a "cost" basis in the hands of the parent the difference between the cost of the stock and the tax basis of the subsidiary's assets is added to or deducted from the earnings or profits of the parent, so that the reduction in invested capital cannot exceed the earnings or profits of the parent. The tax basis of any

assets owned by the subsidiary when the parent purchased the stock of the subsidiary will be determined by reference to the price paid for the subsidiary's stock, and this basis will also be used in determining the earnings or profits of the parent company for periods after the liquidation of the subsidiary.

When the stock of the subsidiary has other than a "cost" basis, the difference between the basis of the stock and the basis of the assets is a direct addition to or deduction from the equity invested capital of the parent. Any reduction may therefore exceed the earnings or profits of the parent and to that extent the new provisions are inequitable, particularly in cases where the subsidiary has incurred large losses after its stock was acquired by the parent. The tax basis of the assets, under this paragraph, will be the cost of the assets to the subsidiary.

The new rules will apply not only to liquidation under section 112(b)(6) but also to tax-free liquidations during consolidated income or excess profits tax return periods. The new rules, at the taxpayer's election, may be applied to all taxable years beginning after December 31, 1939.

Capital Reduction for Certain Intercorporate Transactions

As under prior law, corporations using the base period income credit must reduce the credit by 6 per cent of any capital reduction, representing distributions to shareholders not out of earnings or profits.

The new law treats as a capital reduction any net increase in the investments in stocks of corporations which are members of the same controlled group, occurring after the beginning of the taxpayer's first excess profits tax year. The adjustment cannot exceed the excess of the investments in all domestic stocks and tax-exempt bonds over the amount of the investments in such stocks and bonds at the beginning of the taxpayer's first excess profits tax year.

The amendment was apparently designed to prevent tax avoidance by corporations, which have a base period income credit, transferring part of their business to subsidiaries which may use an invested capital credit. It is particularly objectionable in its retroactive application to all transactions occurring after the beginning of the first taxable year, even though they may have been consummated for bona fide business reasons.

Deficit of Predecessor Corporation

Under prior law when a corporation with an operating deficit was reorganized into a new corporation, in a tax-free reorganization the starting point of the invested capital of the new company was the tax basis of the assets transferred, and accordingly the capital originally

invested in the predecessor company was reduced by the operating deficit. The new law, in particular circumstances, allows the deficit of the predecessor to be added to the invested capital of the new company. The deficit is then treated as a recognized loss of the new company, and accordingly reduces invested capital only to the extent of the accumulated earnings or profits of the new company.

The amendment is unduly narrow and covers only simple reorganizations of one company into another where all of the stock of the new company (which must be the sole consideration for the assets) goes to the stockholders of the old company. The amendment applies to taxable years beginning after December 31, 1939.

Income Credit in Connection with Certain Exchanges

Under prior law, apparently as a result of an oversight, a corporation which elected to include in its base period income the income of a corporation the assets of which were acquired under certain conditions, could not take advantage of the growth provision applicable to corporations with increased earnings in the last half of the base period. This inequity has been eliminated retroactively to taxable years beginning after December 31, 1939, at the taxpayer's election. The new law contains various other modifications of the income credit of corporations acquiring the assets of other corporations, which generally are of a liberalizing nature.

Adjustment in Case of Inconsistent Position

Prior law required that if in computing an excess profits credit a taxpayer treated an item inconsistent with the treatment accorded such item in determining the income tax liability of the taxpayer *or a predecessor* for a prior year, there would be added to the excess profits tax the tax that should have been paid for the prior year. The prior law did not define the term "predecessor." An amendment, which applies to taxable years beginning after December 31, 1939, considerably restricts the very broad definition of a "predecessor" contained in the regulations issued under prior law, and accordingly eliminates a serious hardship which might arise under such regulations.

Capital Stock and Declared Value Excess-Profits Taxes

The capital stock tax and declared value excess-profits tax have been retained at the same rates as under prior law. For the year ended June 30, 1942 (in the capital stock tax return due November 28, 1942) an entirely new declaration is permitted, and under the Code as amended by the Revenue Act of 1942 a new declaration will be permitted each succeeding year.

It will be necessary to declare in the return for the year ended June 30, 1942 a value at least ten times the earnings before deducting federal normal tax, surtax and excess profits tax for any year ending after June 30, 1942, and before July 1, 1943, if the payment of any declared value excess-profits tax is to be avoided.

The effect of an insufficient declaration of value may be illustrated as follows:

Declared value	$2,000,000
Actual earnings	$ 400,000
Exemption, 10% of $2,000,000	200,000
Balance subject to declared value excess-profits tax	$ 200,000
Declared value excess-profits tax:	
6.6% of $100,000 (5% of $2,000,000)	$ 6,600
13.2% of balance ($200,000 less $100,000)	13,200
	$ 19,800
Federal capital stock tax: $1.25 per $1,000 on $2,000,000	2,500
Total tax	$ 22,300

In this case, if a value of $4,000,000 had been declared, there would be no declared value excess-profits tax and the total tax would be $5,000 ($1.25 per $1,000) or a gross saving of $17,300 before considering the effect on normal tax, surtax and excess profits tax.

No federal taxes based on income are allowed as deductions in computing the net income subject to the declared value excess-profits tax, but the declared value excess-profits tax is deductible in arriving at the regular excess profits net income, normal-tax net income and corporation surtax net income. Because the capital stock tax is also deductible, both taxes will yield little net revenue and it is unfortunate that the conferees did not accept the Senate's proposal to eliminate these taxes.

Individual Income Determination

Capital Gains and Losses

As in the case of corporations, the dividing line between long-term capital gains and losses and short-term capital gains and losses is reduced from 18 months to 6 months.

If the capital asset has been held for more than 6 months, only 50 per cent of the capital gain is taken into account. If there is a net long-term capital gain in excess of any net short-term capital loss the tax on such excess cannot exceed 50 per cent of the amount of gain taken into account, making the maximum effective rate on such excess 25 per cent (50 per cent of 50 per cent).

Capital losses (whether long-term or short-term) are deductible only from capital gains, plus the ordinary net income or $1,000, whichever is smaller. A net capital loss

sustained in any taxable year beginning after December 31, 1941 (without regard to the holding period) can be carried forward as a short-term capital loss for five years and until used up can be applied against any excess of capital gains over capital losses (regardless of the holding period) plus the ordinary net income or $1,000, whichever is smaller.

A net short-term capital loss of the last taxable year beginning in 1941 (not in excess of the net income of such year) may be treated as a short-term capital loss in the succeeding year to the extent of the net short-term capital gain of the succeeding year.

Non-Trade or Non-Business Deductions

To alleviate the harsh rule of *Higgins v. Com'r*, 312 U. S. 212, the new law permits an individual to deduct "all the ordinary and necessary expenses . . for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income." The usual expenses of an investor should now be allowable deductions, even though the investor is not engaged in a trade or business. Deductions allocable to tax-exempt income, including tax-exempt interest, will not be allowable.

The amendment is retroactive to all prior Revenue Acts, and accordingly refund claims should be filed in appropriate cases if not barred by the statute of limitations.

Bad Debts

A bad debt incurred by an individual other than in the taxpayer's trade or business will be treated as a short-term capital loss and accordingly will be subject to the restrictions previously discussed under "Capital Gains and Losses." If the debt is evidenced by a "security," as defined in the Act, the capital loss will be short-term or long-term, depending upon the holding period.

Alimony and Separate Maintenance Payments

The new law permits a husband to deduct payments required to be made to his wife, under a decree of divorce or of separate maintenance or under a written instrument incident to such divorce or separation. Such payments will be taxable to the wife. Payments for the support of minor children of the husband are not covered by the new provision. Alimony trusts are discussed in another article in this issue.

Payments to Cooperative Apartment Corporations

With certain restrictions, payments made by a tenant-stockholder to a cooperative apartment corporation to cover taxes and interest will be deductible, thus placing such tenants in the same position as a home-owner.

State and Local Taxes

State and local sales taxes, which are separately stated, will be deductible by the purchaser if paid by him, even though they are technically levied against the seller.

Fiscal Year Taxpayers

As in the case of corporations, individuals with fiscal years beginning in 1941 and ending after June 30, 1942, must compute a tentative tax at the 1941 rates and at the 1942 rates and use the proportion of each which the number of days before and after June 30, 1942, bear to the total number of days in the taxable year. In both computations the net income must be computed under the law applicable to 1941, including the alternative taxes on capital gains and losses.

Compensation for Services Extending over Thirty-Six Months

Under prior law when an individual received not less than 95 per cent of his compensation on the completion of services extending over a period of five years or more, the income could in effect be allocated back for tax purposes over the period the services were rendered. The new law reduces the period to thirty-six months, and reduces the percentage of compensation payable at completion of the services from 95 per cent to 80 per cent. For taxable years beginning after December 31, 1940, and before January 1, 1942, the factors are sixty months and 75 per cent of the compensation.

Interest to Carry Life Insurance

Interest on indebtedness incurred or continued to purchase single premium life insurance or endowment contracts will not be allowed as a deduction. The policies are considered single premium if substantially all the premiums are paid within four years.

Extension of Statutory Limitation on Refund Claims

Where the taxpayer has agreed to an extension of the statutory period for assessing additional taxes, refund claims may be filed within six months after the expiration of such extended period. This is a long needed change, but it is effective only as to overpayments for taxable years beginning after December 31, 1941, excepting that with respect to bad debts and worthless securities it is applicable to taxable years beginning after December 31, 1938.

Relief Provisions Relating to Excess Profits Tax

By J. Marvin Haynes and Wallace C. Magathan
(*Washington Office*)

The relief provisions of the Excess Profits Tax Act may prove to be the most important in the law for many corporate taxpayers, not only in view of the large increase in the burden of the excess profits tax under the 1942 Act, but also because the 1942 amendments greatly broaden the scope of relief and are retroactive to January 1, 1940.

In discussing herein the relief provisions reference will be had principally to those contained in sections 711, 721 and 722 of the Internal Revenue Code.[1] Many amendments made by the 1942 Act are in effect relief provisions, since they specifically correct provisions of the Code so as to relieve inequitable situations disclosed by the administration and interpretation of the revenue laws. Others retroactively amend provisions of prior laws for similar reasons. Among such provisions are those enacted for the relief of installment basis taxpayers and of taxpayers with income from long-term contracts (section 736). However, although such amendments definitely grant relief by reason of changes in the wording of the law, they are not, strictly speaking, relief provisions such as sections 711, 721 and 722. Of the three sections named the Congressional Committees refer only to section 722 as the "relief" provision. It seems proper, nevertheless, to treat sections 711 and 721 in this category, since they are general provisions which grant relief from the rigors of the statute in given circumstances.

Relief Sections

Section 711 grants relief to taxpayers using the average income basis (that is, computing the excess profits credit on the basis of the *average income of the 1936–1939 base period*) by permitting the elimination of certain abnormal deductions taken in the base period years.

Section 721 grants relief to taxpayers by permitting them to arrive at a normal net income *for a taxable year* in the war period by eliminating items of income from the taxable year, and transferring them either to previous taxable years or to subsequent taxable years to which under the statute they are properly attributable.

By contrast with sections 711 and 721, which deal with the *actual*

[1] All section references hereinafter are to the Internal Revenue Code as amended by the 1942 Revenue Act.

income of either the base period year or the taxable year, section 722 provides relief by permitting the taxpayer to determine a *constructive* average base period income on certain assumptions.

In the 1942 amendments sections 711 and 721 are but slightly changed. The principal, and by far the most important, changes were made in section 722, and the comments which follow will deal only with the changes in this latter section.

Except for the fact that section 722 retains the framework given it by the 1941 amendments, it has been otherwise rewritten. It retains the scheme of granting relief to corporations on the average income basis, but extends it to corporations which were required to use the invested capital basis of computing the excess profits tax credit. Corporations which voluntarily choose to use the invested capital basis may now change retroactively to the average income basis and claim benefit of the relief provisions.

General Rule as to Relief Under Section 722

Generally speaking, relief is allowable under section 722, provided the taxpayer establishes two requisites:

1. That the excess profits tax computed without the benefit of the section would be excessive and discriminatory; and
2. What would be a fair and just amount (representing normal earnings) to be used as a constructive average base period net income for the purpose of computing an excess profits tax based upon a comparison of such normal earnings with the earnings of an excess profits tax year.

This general rule applies whether the taxpayer elects to use the average base period earnings method of computing the excess profits tax credit, or whether it uses the invested capital method of computing such credit, either by its own election or because it is required by law to use the latter method by reason of the taxpayer corporation not having been in existence on January 1, 1940. However, the conditions or circumstances or abnormalities which must exist to permit the construction of so-called normal earnings differ as between corporations which have the option of electing either the average earnings method or the invested capital method and those corporations which are required to use only the invested capital method.

A further general rule that applies to all classes of corporate taxpayers claiming relief is that in reconstructing the base period earnings to determine normal earnings, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally, which occur or exist after December 31, 1939. This rule is set up in order to

eliminate consideration of the effects of the war, such as high war prices, swollen demand, and other factors which would not be normal prior to the imposition of the excess profits tax. An exception to this rule is made in cases where there has been a "change in the character of the business" or "the nature of the taxpayer" as these phrases are defined in the law. This exception permits the consideration of events or conditions after December 31, 1939, to the extent that may be necessary to establish the constructive normal base period earnings.

Taxpayers can probably better understand these general rules and make a more intelligent application, not only of them but also of the special rules hereinafter discussed, if they will first bear in mind the theory of the excess profits tax, viz., that it is intended to apply only to those profits which exceed normal profits. The excess profits credit is supposed to represent the norm, whether computed with or without the benefit of the relief provisions. Section 722 is in the law to permit normal income to be arrived at in cases in which this could not otherwise be done under the law. If taxpayers will thus view the relief sections, and examine their cases in this light, they will be better able to determine whether the tax appears to be "excessive and discriminatory."

Relief For Corporations Entitled to Use Average Earnings Method

Corporations in existence prior to January 1, 1940, are permitted to apply for relief whether in their returns they elect to compute their excess profits tax on the average-earnings basis or by the invested-capital method. To one reading the statute without this distinction in mind it would appear that no provision is made for relief to corporations which elect to use the invested-capital method. The report of the Ways and Means and the Senate Finance Committees (if there were any doubt in the language of the section) makes the matter clear. The Finance Committee in its report (Report No. 1631, 77th Congress, 2d Session), on page 25, states:

> This relief is granted all taxpayers in existence during the base period, even though they computed their excess profits on the invested-capital basis. Taxpayers who did not come into existence until after the base period, are permitted to have their income constructed for the base period on a basis comparable with other taxpayers similarly situated.

Therefore, as to taxpayers in existence before January 1, 1940, relief is to be determined by the use of constructive base period average earnings, irrespective of whether they use the average-earnings method or the invested-capital method.

In order to be entitled to the benefits of the section, a taxpayer must prove that the excess profits tax computed without the benefit of the section is "excessive and discriminatory," that the average base period net income is not a fair measure of normal earnings, and that abnormal conditions affected its business during the base period, such as:

1. That in one or more years in the base period, production, output or operation was interrupted or diminished because of the occurrence of events unusual and peculiar in the experience of such taxpayer, either during or immediately prior to the base period, or,
2. That the industry of which the taxpayer is a member was depressed during the base period because of temporary economic events unusual in such industry, and as a result the business of the taxpayer during such period was depressed, or,
3. That irrespective of the industry as a whole the business of the taxpayer during the base period was depressed because of temporary economic circumstances unusual in its business experience, or,
4. That the business of the taxpayer was depressed during the base period because of conditions generally prevailing in its industry, which either
   - (a) subjected the taxpayer to a profits cycle differing materially in length and amplitude from the business cycle experienced by all kinds of business generally, or
   - (b) subjected the taxpayer to sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period, or,
5. That the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business, and the average base period net income does not reflect the normal operation for the entire base period of the business. The law defines neither the term "commenced business" nor "change in the character of the business," but a number of different situations are set forth as being *included* within the meaning of the latter term. Among these are "a change in the operation or management of the business," "a difference in the products or services furnished," "a difference in the capacity for production or operation" and "a difference in the ratio of nonborrowed capital to total capital."

In addition to the five specific

abnormalities or situations or conditions creating abnormal earnings during the base period above set out, the section contains a final "catch all" provision phrased as follows:

(or) . . . because . . . of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

The Senate Finance Committee says of this provision at page 202 of its report:

Thus, corporations which do not meet the strict eligibility requirements set forth in this section are not debarred from relief if their case is within the spirit of the statute and if its application would not be inconsistent with its principles and conditions and limitations.

Many examples are given in the Ways and Means and the Senate Finance Committee reports to illustrate the application of these subsections to specific cases, which should be helpful to taxpayers in considering the possibilities of relief in their own cases. These illustrations probably will be set forth in the amendments to be made to Regulations 109 and 110.

Relief for Corporations Not Entitled to Use Average-Earnings Method

Those corporations which have come into existence since December 31, 1939, are required by section 714(a) of the law to use the invested-capital method to compute their excess profits credit. Section 722 provides relief for such corporations under certain circumstances, provided the excess profits tax computed without the benefit of the section is excessive and discriminatory, and the excess profits credit based on invested capital would be an inadequate standard for determining excess profits. Such taxpayers will be entitled to use a credit based on income, using a constructive base period net income as for corporations in existence prior to January 1, 1940, if they can establish one of the following abnormalities:

1. That the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income, or,
2. That the business of the taxpayer is of a class in which capital is not an important income producing factor, or,
3. That the invested capital of the taxpayer is abnormally low.

The Congressional reports likewise give examples illustrative of the application of these provisions which should be considered by taxpayers of this class who believe that their excess profits as determined under other sections of the law include some normal profits.

Limitations on Relief

By the 1942 amendments, which, as has been stated, are retroactive to all excess profits tax returns heretofore filed, Congress has removed the arbitrary limitations on the amount of relief heretofore contained in section 722. This was done because under the high rates, a corporation entitled to relief should not be denied the benefits thereof because the amount of its tax saving did not satisfy certain arbitrarily fixed standards. However, the limitations on the type of relief provided by sections 711 and 721 have been retained and broadened. This is more particularly true as to the latter section. Such changes are of specific rather than of general interest.

Making Claim for Relief

Relief under sections 711 and 721 should be claimed on the return. If this is not done, or if changes in the law provide greater relief, claims for refund should be filed. Taxpayers should understand that there are certain inherent relationships set up by the statute between claims under sections 711 and 721 and 722. Taxpayers should, therefore, consider their possible claims under 722 in conjunction with the application of sections 711 and 721 to their returns.

Relief under section 722 may have been claimed heretofore in accordance with the section as in prior laws. These claims should now be reviewed and new claims filed if section 722 as amended or other retroactive provisions of the law change the claim. Doubtless most of such claims will be affected, and applications for relief in such cases must be filed within six months after October 21, 1942, or on or before April 21, 1943.

When relief has not been claimed under section 722 for prior years, it is imperative that the question be considered at once. Applications for relief in such cases must be filed on or before April 21, 1943.

As to current returns the tax must in the first instance be computed without the benefits of section 722. However, subject to regulations to be issued, relief under the section may be claimed on the return or may be claimed separately by an application filed not later than six months after the date prescribed by law for filing the return. When the benefits of section 722 are claimed on the return, the law provides a method for the deferment of the tax payable at the time prescribed for payment, to the extent of 33 per cent of the amount of the reduction in the tax claimed to result from the application of section 722. This method of deferment is limited to those cases in which the return as filed shows that the adjusted excess profits net income (computed without reference to section 722) is in excess of 50 per cent of the normal-tax net income computed without the credit for adjusted excess profits income.

All applications for relief, whether for current or prior years, must be filed in accordance with regulations to be prescribed by the Commissioner of Internal Revenue.

Should a taxpayer not make an application under the several situations above described, he may thereafter make application for relief if the Commissioner proposes a deficiency in a preliminary notice (usually a so-called 30-day letter). However, in all such cases the amount of the relief is limited since it is provided that the effect of the application shall not be such as to bring about a refund of excess profits tax. In the words of the statute this limitation provides that:

> . . . the operation of this section shall not reduce the tax otherwise determined under this subchapter by an amount in excess of the amount of the deficiency finally determined under this subchapter without the application of this section.

Review of Abnormalities By The Tax Court of the United States[2]

The Tax Court of the United States is given jurisdiction to review claims for relief, not only under section 722, but also any questions arising as to relief under sections 711(b) (1) (H), (I), (J) or (K), and section 721 with respect to abnormalities in the base period and in the income of the taxable year. This review may arise from the rejection of a claim for refund based on an application otherwise made in accordance with the law. The review is upon petition from a notice of disallowance of the application, in the same manner as review is obtained as to the determination of a deficiency. In cases where no application for relief has been filed and the Treasury determines a deficiency, the taxpayer may in his petition raise the question of relief and thus secure a review. As has been pointed out, the relief in such case is limited to the amount of the deficiency determined.

A special division of the Tax Court is provided for, whose duties are to review the determinations and redeterminations by any division of such Court as to any question arising under section 721 (a) (2) (C) or section 722. The decisions of this special division are not reviewable by the Tax Court and are deemed decisions of the Court. When a decision of the Tax Court relates to the redetermination of a taxpayer's tax liability solely by reason of the application of sections 711 (b) (1) (H), (I), (J) or (K), section 721 or section 722, the law provides that such determinations are not reviewable by any other court or agency. When other questions affect the tax liability the decisions of the Tax Court are reviewable by the Circuit Court of

(*Continued on page 31*)

[2]By section 504 of the 1942 Act the name of the Board of Tax Appeals was changed to The Tax Court of the United States.

The L. R. B. & M. Journal

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The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

The 1942 Revenue Act

Probably the most voluminous, and certainly one of the most complex, pieces of revenue legislation ever enacted by Congress is the 1942 Revenue Act which became law on October 21. The layman who is theoretically presumed to know the law, or suffer the penalty of his lack of knowledge, will certainly not live long enough to master it, and the practitioner will not for a long time understand all its intricacies and be assured of their significance. In any event, it will be years before some of its provisions will have run the gamut of one of the several legal courses provided in the Internal Revenue Code, as, for example, Treasury ruling, trial before The Tax Court of the United States (the new name for the Board of Tax Appeals, which was created in 1924), review

by a federal circuit court, and finally a decision by the United States Supreme Court.

The 1942 Act is in the form of various amendments of the Internal Revenue Code and is the more complex because section numbers are used in the Act which differ from the section numbers of the Code provisions affected by the amendments.

One thing may be said for the 1942 Act, namely, that there was an evident intent to remedy various inequities and hardships which had developed or been disclosed in the course of the administration of the Code provisions. Some of these remedial provisions were either suggested by or had the cordial support of the Treasury as, for example, the amendment to overcome the unfair results of the decision in the well known *Higgins* case.

Other remedial provisions were incorporated in the 1942 Act as the result of representations by taxpayers to the Congressional committees charged with the framing of the Act. Too much emphasis cannot be placed on the importance of taxpayers exercising their constitutional right to make themselves heard when their interests are affected and especially when interests are, or are in danger of, being prejudiced by unreasonable or inequitable tax provisions.

The current issue of the L. R. B. & M. JOURNAL is devoted to a consideration of the more important provisions of the 1942 Revenue Act, in continuation of our firm's long standing practice of having the issue of the L. R. B. & M. JOURNAL immediately following a new federal tax law devoted to an analysis of important changes in our national tax structure.

The various articles in this issue will, it is believed, be helpful to our staff in mastering the important provisions of the 1942 Act, and are commended to their careful study.

Montgomery's Federal Taxes on Corporations

The above caption will be the title of the two tax books which will constitute the 1942–43 edition of Colonel Montgomery's long series of works on taxation which began with the publication of his first book on Income Tax Procedure in 1917.

One volume of the 1942–43 edition will bear the subtitle of Gross Income and Deductions, and be devoted to the many different elements which enter into the determination of corporate income for normal tax, surtax and excess profits tax purposes. As the publisher expresses it,

> It gives all-angle consideration to questions like reorganizations; non-taxable exchanges; tax basis; corporate distributions, including stock dividends; capital gains and losses; accelerated depreciation; handling amortization of emergency facilities. It points out and clarifies all changes, whether

statutory or by reason of Treasury rulings, court or Tax Board decisions.

Throughout, it helps you find alternative and possibly more favorable courses; points out to you the important consequences of specific action, particularly if conditions change; helps you see the possibly limiting effects of precedents you may establish.

The other volume will bear the subtitle of Tax Determination and Returns, and will deal at length with the difficult subject of the excess profits tax in all its ramifications, including average earnings of the prewar base period, invested capital, abnormalities in both prewar years and taxable years of the war period, relief provisions for cases of undue hardship, consolidated returns for both excess profits and income tax purposes, the capital stock and declared value excess-profits taxes, and numerous other features of the determination of tax liability and the making of returns by corporations. Again, as stated by the publisher,

It gives particular attention to the intricacies of the *excess profits tax*, where most of a company's hardest problems arise, and where missteps or neglected opportunities are most costly. It explains the effect of new provisions, and of changes in computing the tax; applies wide experience under successive excess profits tax laws to help you elect and follow through, under the many options provided, the course best suited to company needs.

The books are expected to come from the press next month and are commended to our staff for detailed study and for guidance in serving our clients in the most effective manner regarding their tax problems.

W. A. S.

Relief Provisions Relating to Excess Profits Tax

(*Continued from page 28*)

Appeals and on writ of certiorari by the Supreme Court of the United States.

General Observations

Because of the rather short time limits prescribed for the filing of applications for relief, and because the questions involved are complex, and further because taxpayers and their accountants, already short-handed, will be heavily burdened in making returns, irrespective of claims for relief, it is imperative that consideration be given at once to these claims. The existence of a basis for the claims or the legal right thereto of the taxpayer is not always apparent on the surface; therefore careful analysis is always required in their preparation. If a liberal allowance of time is not made for preparation, taxpayers may lose the relief which Congress intended they should have, either because the claims are not properly prepared as to basis, or because they are not filed in time.

Amendments Affecting Estates, Trusts and Gifts

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A number of the amendments of the Internal Revenue Code which were made by the Revenue Act of 1942 affect estates, trusts and gifts. The more important of these are considered in this article.

Income Tax

INCOME TAX RATES

The changes in rates of normal tax and surtax are applicable to estates and trusts and the beneficiaries thereof for taxable years beginning after December 31, 1941. The normal tax is six per cent. The surtax rates are as shown in the table on page 49.

INCOME FROM GIFT, BEQUEST, OR DEVISE TAXABLE

The principle of *Irwin* v. *Gavit* (268 U. S. 161), viz., that amounts received under a gift, bequest, or devise of a right to income from property are to be included in gross income,—is written into the statute with respect to taxable years beginning after December 31, 1941.

ANNUITIES CHARGEABLE AGAINST CORPUS, OR CORPUS AND INCOME

The principles of *Burnet* v. *Whitehouse* (283 U. S. 148) (viz., that amounts received under a gift, devise, bequest or inheritance of recurrent payments to be made in any event, whether or not of corpus, are not income to the recipient) and *Helvering* v. *Pardee* (290 U. S. 365), (viz., that the fiduciary, in computing net income under section 162 of the Code, cannot deduct the amount of trust income distributed in payment of an annuity chargeable against corpus, or corpus and income) are repudiated. Under the amendment, applicable to taxable years beginning after December 31, 1941, any amounts receivable, at intervals, under a gift, devise or inheritance and payable out of corpus or out of income or corpus, are to the extent actually paid out of income, to be included in the gross income of the recipient. A gift or bequest of money or property to be paid *in a lump sum or at one time* remains nontaxable as income even though it is actually paid out of income, unless it is specifically provided that the gift or bequest is limited to the income of property.

In any case in which the fiduciary can or must pay, credit or distribute the whole or any part of a gift, bequest, devise or inheritance (except a *lump sum* gift, bequest, devise or

inheritance) out of corpus (as for example, where a deficiency in the amount can be made up by a payment out of corpus), the amount paid, credited or to be distributed during the taxable year of the estate or trust (beginning after December 31, 1941) is deductible by the fiduciary and must be included in the gross income of the beneficiary if the aggregate of such amounts so paid, credited or to be distributed is equal to or less than (A) the statutory net income of the estate or trust computed with the deductions for income distributable or properly paid or credited to beneficiaries or (B) the income (the amount available for distribution to the beneficiary under the applicable law of estates and trusts, as distinguished from the Internal Revenue Code) minus the deductions allowed by the Code for income distributable or properly paid or credited to beneficiaries, whichever is greater. If the aggregate of the amounts so paid, credited or to be distributed during the taxable year of the estate or trust exceeds the greater of the factors (A) and (B) discussed in the preceding sentence, that proportion of the amounts so paid, credited or to be distributed which bears the same ratio to the greater of the factors (A) and (B) referred to above as the amount so paid, credited or to be distributed bears to the aggregate of such amounts so paid, credited or to be distributed to beneficiaries for the taxable year is deductible by the fiduciary and must be included by the beneficiary in gross income.

Income Collected by Guardian of Infant

The clause allowing as an additional deduction from the gross income of a fiduciary the amount of income collected by a guardian of an infant which is to be held or distributed as the court may direct is eliminated as ambiguous and unnecessary. This amendment is applicable to taxable years beginning after December 31, 1941.

The clause "income which is to be distributed currently" (allowed as an additional deduction from the gross income of the fiduciary) is defined (with respect to income which is to be distributed on or after the beginning of the first taxable year of the estate or trust, beginning after December 31, 1941) to include income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir or beneficiary.

Income Payable More Than 65 Days After Beginning of Taxable Year

In all cases (except cases in which the fiduciary can or must pay, credit or distribute, out of corpus, the whole or any part of a gift, bequest, devise or inheritance which is payable at intervals) if on a date more than 65 days after the beginning of the taxable year of the estate or

trust, income of the estate or trust for any period becomes payable, the amount of such income, *to the extent of the income of the estate or trust for such period,* or if such period is longer than twelve months, the last twelve months thereof, is deductible by the fiduciary and must be included by the beneficiary in gross income. The amendment is applicable to income paid, credited or to be distributed on or after the beginning of the first taxable year of the estate or trust beginning after December 31, 1941.

Income Payable Within First 65 Days of Taxable Year

If within the first 65 days of any taxable year of the estate or trust, income of the estate or trust, for a period beginning before the beginning of the taxable year becomes payable, such income, to the extent of the income of the estate or trust for the part of such prior period not falling within the taxable year, or if such part is longer than twelve months, the last twelve months thereof, is deductible by the fiduciary and must be included in the gross income of the beneficiary as of the last day of the preceding taxable year. The amendment is applicable to income paid, credited or to be distributed on or after the beginning of the first taxable year of the estate or trust beginning after December 31, 1941.

If within the first 65 days of any taxable year of the estate or trust, an amount which can be paid at intervals out of corpus becomes payable, that part of such amount which bears the same ratio to such amount as the part of the interval not falling within the taxable year bears to the period of the interval (or if the part of the interval not falling within the taxable year is a period of more than twelve months, to the twelve months before the end of the taxable year) is deductible by the fiduciary and must be included in the gross income of the beneficiary as of the last day of the preceding taxable year. The amendment is applicable to amount paid, credited, or to be distributed on or after the beginning of the first taxable year of the estate or trust beginning after December 31, 1941.

Trusts for Payment of Alimony

There must be included in the gross income of a wife or former wife, or husband or former husband who is divorced or legally separated under a decree of divorce or of separate maintenance, the amount of the income of any trust which such wife, former wife, husband or former husband is entitled to receive and which, except for the amendment, would be includible in the gross income of her husband or former husband, or his wife or former wife, and such amount shall not be included in the gross income of her husband or former husband or his wife or former wife. This amendment was designed to make

alimony and payments in lieu of alimony taxable to a divorced wife and not to the husband. If the taxable years of the husband and wife begin on the same day, the amendment is applicable to taxable years beginning after December 31, 1941, in the case of the spouse entitled to receive the income and also in the case of the spouse who would, except for the amendment, be taxable on the income. If the taxable years of the husband and wife begin on different days, the amendment is first applicable, in the case of the spouse who would, except for the amendment, be taxable on the income, on the first day of the taxable year, beginning after December 31, 1941, of the spouse entitled to receive the income.

In case the decree of divorce or of separate maintenance, or a trust instrument described in the paragraph preceding, specifies an amount of money or a portion of the income of the trust as a sum which is payable for the support of minor children of the spouse who created said trust, such income remains taxable to said spouse, if it would be taxable to him except for the amendment, and if the income of the trust is less than the amount so specified, all of the income is so taxable. This amendment is applicable to the same period as stated in the last preceding paragraph.

For the purposes of computing the net income of the estate or trust and the net income of the spouse entitled to receive the income of a trust described above, such spouse is considered as the beneficiary specified in Supplement E.

Credits in Case Bond Interest Is Amortized

If the estate or trust elects to treat the premiums on bonds of the United States or instrumentalities thereof (other than a bond the interest on which is wholly exempt from income tax) as amortizable, and if all of the income of the estate or trust is taxable to the fiduciary, the credit allowed to the estate or trust for the interest on said bonds must be reduced by the amount of the amortizable bond premium for the taxable year.

If the estate or trust owns a bond the interest on which is entirely exempt from income tax, it is mandatory that the premium on the bond be amortized. However, no deduction is allowed on account of such amortizable premium, the amortizable premium for the taxable year being simply an adjustment to the basis or adjusted basis of the bond.

If the estate or trust elects to treat the premiums on bonds of the United States or instrumentalities thereof (other than a bond the interest on which is wholly exempt from income tax) as amortizable, and if any part of the income of the estate or trust is taxable to any legatee, heir or beneficiary, the credit allowed to such legatee, heir or bene-

ficiary for his proportionate share of such interest must be reduced by the amount of the amortizable bond premium attributable to his share. The remainder of such amortizable bond premium must be applied to reduce the credit allowed to the fiduciary for the portion of such interest not allowed as a credit to the legatees, heirs, or beneficiaries.

In the case of a decedent on the cash receipts and disbursements basis owning a wholly tax-exempt bond, the amortizable premium for the period ending with his death reduces his basis of the bond. If the bond is fully taxable, the interest accruing for the taxable year up to the date of his death is carried over to the estate or legatee, but the deduction for the period on account of the amortizable premium is allowed the decedent. If the bond is partially tax-exempt, the interest is similarly carried over to the estate or legatee and although the deduction for amortized premium up to the date of death is allowed on the decedent's final return, the credit of the estate or of the legatee for the partially exempt interest will not be reduced.

Accruals of Fiduciaries

Every fiduciary must file return—

For every individual for whom he acts who is single or not living with his or her spouse, and for every estate for which he acts, having a gross income for the taxable year of $500 or over (instead of $750 or over).

For every individual for whom he acts who is living with his or her spouse, having a gross income of $1,200 or over (instead of $1,500 or over).

The amendment is applicable to taxable years beginning after December 31, 1941.

Accruals to Date of Death

The provisions requiring the inclusion in a decedent's income and the allowance as deductions and credits for the taxable period ended with his death, of all amounts of gross income accrued up to the date of his death and all deductions and credits accrued up to the date of his death, is repealed and a provision inserted to the effect that in the case of a decedent on the accrual basis, amounts (except amounts includible or deductible in computing a partner's net income) which would be includible in the income of or allowable as deductions and credits to such decedent solely by reason of his death, shall not be included in computing his income for the taxable period ending with his death. Death does not, under the amendment, effect any change in the accounting practice used by the decedent during his lifetime. This amendment is applicable to taxable years beginning after December 31, 1942.

All income accrued up to the date

of the death of a decedent (not properly includible in any income tax return of the decedent) is treated as if it had been acquired in the transaction by which the decedent acquired the right to it, and considered to have the character which it would have had in the hands of the decedent if he had lived and is taxable in the taxable year when received, (1) to the estate of the decedent, if the right to receive the amount was acquired by the estate from the decedent, or (2) if the estate did not acquire the right to receive the amount from the decedent or if the amount is received after a distribution by the estate of such right, to the person who did acquire such right by reason of the death of the decedent or by bequest, devise or inheritance. If any such right is transferred (including a sale, exchange or other disposition, but not including a transfer pursuant to the right of the transferee to receive such income by reason of the death of the decedent or by bequest, devise or inheritance from the decedent), there must be included in the gross income of the estate or the person entitled to the income, as above stated, for the taxable period in which the transfer occurs, the fair market value of such right at the time of the transfer or the value of the consideration for the transfer, whichever is greater. Similarly, the amount of any deductions for expenses, interest and taxes, and the amount of any credit for foreign taxes, not deductible by the decedent during his lifetime, is, by the amendment, allowed, for the taxable year in which paid, to the estate, if the estate is liable to discharge the obligation to which the deduction or credit relates, or if the estate is not so liable, to the person who acquires from the decedent, subject to such obligation, an interest in the property of the decedent.

Depletion not deductible by the decedent in his lifetime is allowed as a deduction to the estate or to the person entitled to receive the income to which the depletion relates, in the taxable year when such income is received.

The estate or person required to include in gross income, income of a decedent accrued during the lifetime of the decedent and not includible in any income tax return of the decedent, is allowed, for the taxable year of such inclusion, a deduction for estate taxes, determined as follows: The net value for estate tax purposes of all of the income accrued during the decedent's lifetime and not includible in any income tax return of the decedent is determined by deducting from the value for estate tax purposes of all such income the deductions from the gross estate in respect of claims which represent expenses, interest, taxes, depletion and foreign taxes accrued during the decedent's lifetime and not deductible or subject to a credit in his tax returns. The estate tax attributable to such net

value is determined by reducing the gross estate by the amount of such net value and computing an estate tax on such reduced amount; the excess of the actual estate tax over the estate tax so computed is the estate tax attributable to such net amount. The deduction for estate tax is an amount which bears the same ratio to the estate tax attributable to such net value as the value for estate tax purposes of the gross income included in the taxpayer's return (or the amount included, whichever is lower) bears to the value for estate tax purposes of all such income accrued during the lifetime of the decedent and not includible in his tax returns. These amendments are applicable to taxable years ending after December 31, 1942. But see the next succeeding paragraph.

In the case of decedents who died (or dying) during the calendar years 1934 to 1942, both inclusive, the amendments described in the two paragraphs next preceding may be made applicable to the last taxable period of the decedent and to subsequent taxable years of the estate and of the heirs, legatees, devisees and beneficiaries by the filing with the Commissioner of consents signed and sworn to by the fiduciary and each person, or his legal representative, to whom income accrued prior to the death of the decedent and not includible in any of his tax returns is payable after his death. If such consents are filed after the time for the filing of the return for any period during which any such income is received, the deficiency resulting from the failure to compute the tax in accordance with the amendments shall be paid when the said consents are filed and may be assessed and collected within one year after the date of such filing, even though the ordinary statute of limitations expires prior to the end of such year. Similarly, a claim for credit or refund may be filed or a credit or refund allowed without the filing of a claim for any overpayment resulting from a failure to compute the tax in accordance with the amendments may be made within one year after the filing of such consents, except that no such claim may be filed or refund allowed after the running of the ordinary statute of limitations for the taxable period of the decedent ending with his death. If (a) the application of the amendments to the taxable period of the decedent ending with his death results in a deficiency or a refundable overpayment for such period, if (b) the income tax of the decedent for such period was deducted in computing the gross estate for the purposes of the estate tax, or in the case of a resulting overpayment, if such overpayment was included as part of the income tax so deducted, and if (c) at the time of the assessment of such deficiency or the credit ing or refunding of such overpayment, the statute of limitations has run on the crediting or refund, or

the assessment, of the estate tax, then the assessment or the overpayment of income taxes for the last taxable period of the decedent must be reduced by the resulting overpayment or deficiency, respectively, in estate taxes.

Basis of Property Transferred in Trust by Gift

A transfer in trust by a gift (in addition to transfers in trust by bequest or devise) is excluded from the rule that if property was acquired after December 31, 1920, by a transfer in trust the basis shall be the same as it would be in the hands of the grantor. Under the amendment, the basis of property acquired after December 31, 1920, by a transfer in trust by gift is the same as any other property acquired by gift after December 31, 1920, i.e., the basis in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis, adjusted, is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis is such fair market value.

Basis of Property Valued for Estate Tax Purposes on Anniversary of Death

If property is acquired by bequest, devise or inheritance, or by the decedent's estate from the decedent, and if the executor elects upon his return to determine the value of the gross estate by valuing all the property included therein as of the first anniversary of the decedent's death, or, in the case of property distributed by the executor, or by the trustee under a transfer in contemplation of or intended to take effect in possession or enjoyment at or after death, or under a revocable trust, or sold, exchanged, or otherwise disposed of, at its value at the time of such distribution, sale, exchange or other disposition, the basis shall be the fair market value of such property on the first anniversary of the decedent's death or at the time of such distribution, sale, exchange, or other disposition, whichever is earlier. If property so acquired consists of stock or securities of a foreign personal holding company, the basis shall be such value or the basis in the hands of the decedent, whichever is lower. This amendment is applicable only to property acquired from a decedent dying after the enactment of the 1942 Act.

Amortization of Emergency Facilities

The benefit of the deduction for amortization of emergency facilities is allowed to estates and trusts. The deduction is to be apportioned between the income beneficiaries and the fiduciary under the regulations. The amendment is effective as of October 8, 1940.

Deductions for Funeral Expenses, Administration Expenses and Claims Against the Estate

Funeral expenses, administration expenses and claims against an estate may not, except as stated in the sentence next succeeding, be allowed as a deduction in computing the net income of the estate unless there is filed, within the time and in the manner and form prescribed by the Commissioner, a statement that such amounts have not been claimed or allowed as deductions for estate tax purposes and a waiver of the right to have such amounts allowed at any time as deductions for estate tax purposes. The amendment does not apply to expenses, interest, taxes, depletion and foreign taxes accrued prior to the date of the decedent's death but not deductible in the decedent's tax returns. The amendment, in so far as it relates to ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation or maintenance of property held for the production of income, is applicable to all taxable years not barred by the statute of limitations. In all other respects the amendment is applicable to taxable years beginning after December 31, 1941.

Victory Tax

The victory tax is applicable to estates and trusts. In computing victory tax net income, estates and trusts are allowed the deductions allowed by section 162. Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) is required to make a return under oath for any individual, estate or trust for which he acts, if the gross income of such individual, estate, or trust is in excess of $624 for the taxable year. The victory tax is effective on January 1, 1943.

Estate Tax

Estates to Which Applicable

Except as otherwise expressly provided the amendments to the Code with respect to estate taxes are applicable only with respect to estates of decedents dying after the enactment of the 1942 Act (October 21, 1942, 4:30 P.M. E.W.T.).

Community Property

For the purposes of section 811(c) (transfers in contemplation of death, etc.) and section 811(d) (revocable transfers, etc.) a transfer of community property is considered to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse, or derived originally from such compensation or from separate property of the surviving spouse.

There must be included in the gross estate the interest of the de-

cedent and surviving spouse in community property except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no event shall such interest be included in an amount less than the value of that part of the community property over which the decedent had the power of testamentary disposition.

Powers of Appointment

There must be included in the gross estate any property (except in case of a *bona fide* sale for an adequate and full consideration in money or money's worth), (1) with respect to which the decedent at the time of his death (including cases in which the exercise of the power is subject to a precedent giving of notice, and in which the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised) has a power of appointment, (2) with respect to which the decedent has at any time exercised or released a power of appointment in contemplation of death, and (3) with respect to which the decedent has at any time exercised or released a power of appointment by a disposition intended to take effect in possession or enjoyment at or after the decedent's death or by a disposition under which the decedent has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death, the possession or enjoyment of or the right to the income from the property or the right either alone or in conjunction with any person to designate the persons who shall possess or enjoy the property or the income therefrom. A power of appointment is defined as any power to appoint exercisable by the decedent either alone or in conjunction with any person except—

(A) a power to appoint within a class consisting of no person other than the spouse or former spouse of the decedent; the spouse or former spouse of the creator of the power; descendants (including adopted and illegitimate descendants) of the decedent, his spouse or former spouse; descendants (including adopted and illegitimate descendants), other than the decedent, of the creator of the power, his spouse, or former spouse; spouses of such descendants; and charitable, etc., donees of the class to which legacies are deductible in determining the net taxable estate; and

(B) a power to appoint within a restricted class if the decedent did not receive any beneficial interest, vested or contingent, in the property from the creator of the trust or thereafter acquire any such interest, and if the power is not exercisable to any extent for the benefit of the decedent, his estate, his creditors, or the creditors of his estate;

but if a power of appointment is exercised by the decedent by creating another power to appoint, which is within either exception (A) or (B) above, or both, the value of the property subject to such second power of appointment unreduced by any precedent or subsequent interest not subject to such power, shall be included in the gross estate of the decedent.

Any property includible in the gross estate by reason of a power of appointment exercised or released in favor of a charitable or similar organization may be deducted in determining the net estate.

Unless the will directs otherwise, any person or persons receiving any property, included in the gross estate of a decedent, by reason of the exercise, nonexercise or release of a power of appointment may be compelled to pay a proper proportion of the estate tax.

The amendments are applicable as follows:

(1) In the case of any power of appointment not exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, and created prior to the enactment of the Revenue Act of 1942, the amendments do not apply unless the power is exercised after the date of such enactment.

(2) In the case of any power of appointment exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, and created prior to the enactment of the 1942 law, the amendments will become applicable (a) six months after the termination of any legal disability existing at the time of such enactment (including service in the military or naval forces of the United States during the present war) to release such power; or (b) on January 1, 1943, in case no such disability existed on the date of such enactment.

(3) In the case of any power of appointment created prior to the enactment of the 1942 law, where the decedent dies before January 1, 1943, the amendments are not applicable unless the decedent exercised the power.

For the purposes of the deduction for property previously taxed, property includible in the gross estate of the prior decedent and property included in the total gifts of a prior donor by reason of the existence of, exercise of, or release of power of appointment, and received by the decedent, shall be included in the amount deductible as property previously taxed. The amendment is effective as of February 10, 1939. Claims for refund may be filed within one year after the enactment of the 1942 Act.

PROCEEDS OF LIFE INSURANCE

All amounts receivable by the executor as insurance under policies upon the life of the decedent are to be included in the gross estate whether or not such policies were taken out by the decedent.

That proportion of all amounts (not merely the amounts in excess of $40,000) receivable by beneficiaries other than the executor as insurance under policies upon the life of the decedent which the premiums paid, directly or indirectly, by the decedent, at any time, in the case of a decedent who at any time after January 10, 1941 possessed an incident of ownership (other than a reversionary interest, but including incidents of ownership possessed by the decedent at his death as manager of community property) in the policy, or paid, directly or indirectly, by the decedent, after January 10, 1941, in the case of a decedent who at no time after that date possessed an incident of ownership in the policy, bears to the total premiums paid for the insurance, is to be included in the gross estate of any decedent. Premiums paid with community property of the decedent and surviving spouse shall be considered to have been paid by the insured, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In case any such policy was transferred by the decedent, by assignment or otherwise, and the transfer constituted, in whole or in part, a taxable gift, or would have constituted a taxable gift in whole or in part, if a gift tax had been in effect at the time of the transfer, the amount of premiums paid directly or indirectly by the decedent is to be reduced by an amount which bears the same ratio to the amount paid directly or indirectly by the decedent as the consideration, if any, in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer.

All amounts (not merely the amounts in excess of $40,000) receivable by beneficiaries other than the executor as insurance under policies upon the life of the decedent with respect to which the decedent possessed at his death any of the

incidents of ownership (not including a reversionary interest, but including incidents of ownership possessed by the decedent as the manager of community property) exercisable either alone or in conjunction with any other person are to be included in the gross estate.

Unless the decedent directs otherwise in his will, the beneficiaries of life insurance, the proceeds of which have been included in the gross estate, may be compelled to pay that proportion of the estate tax which such proceeds bear to the net estate plus $60,000.

Limitation on Deductions for Funeral Expenses, Administration Expenses, Etc.

The amount by which the deductions for funeral expenses, administration expenses, claims against the estate, unpaid mortgages upon or indebtedness in respect to property the gross value of the decedent's interest in which is included in the gross estate, and allowances for the support of dependents exceeds the value, at the time of the decedent's death (reduced by the amount of any deduction for losses incurred during the settlement of the estate arising from fires, storms, shipwrecks or other casualties or from theft) of property includible in the gross estate which, or the avails of which would, under local law, bears the burden of the payment of said deductions, shall be disallowed as deductions from the gross estate.

The same principle is applied to the deduction for property previously taxed.

Charitable Pledges

A claim founded upon a promise or agreement of the decedent to make a contribution or gift to or for the use of a charitable or similar donee and enforceable against the estate of the decedent is deductible, even though not contracted for an adequate and full consideration in money or money's worth, if it would have been deductible if it had constituted a bequest.

Property Previously Taxed

The new law makes it plain that the deduction for property previously taxed is to be allowed where only the additional estate tax imposed by the 1932 Act was paid by the estate of the prior decedent. The amendment is effective as of June 6, 1932. Claims for refund may be filed within one year after the enactment of the 1942 Act.

Deductions for Charitable and Similar Bequests

Where an irrevocable disclaimer of a bequest, legacy, devise, transfer or power is made prior to the date prescribed for filing the estate tax return and such disclaimer results in an interest falling into a bequest, legacy, devise or transfer to or for the use of a charitable or similar beneficiary, such resulting interest

is deductible. The amendments are effective as of February 10, 1939.

A deduction for bequests, etc., to charitable and similar beneficiaries is denied if any substantial part of the activities of such beneficiary is carrying on propaganda or otherwise attempting to influence legislation.

Credit for Gift Taxes and Local Death Taxes

The credit for local death taxes is to be deducted before, instead of after, the deduction of the credit for payments of gift taxes.

Liability for Estate Tax and Lien Therefor

The liability for the estate tax and the provisions with respect to the lien therefor are extended to include (in addition to a transferee, trustee or beneficiary) the spouse and surviving tenant of the decedent and any person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, who receives or who has on the date of decedent's death property included in the gross estate.

Exemption of Nonresident Alien Estates

An exemption of $2,000 is granted to nonresident alien estates. No return is required unless the value of the gross estate situated within the United States exceeds said amount.

Period for Filing Petition With Tax Court

A petition to The Tax Court of the United States may be filed within 150 days after the mailing of the deficiency notice if said notice is addressed to an executor outside one of the states of the Union or the District of Columbia. The amendment is applicable to notices of deficiency mailed after the date of enactment of the 1942 law.

Specific Exemption

The specific exemption is increased from $40,000 to $60,000.

Overpayments Determined by Tax Court

In order that a refund of estate taxes determined by The Tax Court of the United States may be made, the court must determine that such overpayment was made within three years before the filing of a claim therefor or within three years of the date of the deficiency notice, whichever is the earlier (instead of within three years of the filing of the petition).

Gift Tax

Gifts to Which Amendments Applicable

Except as otherwise expressly provided, the gift tax amendments are applicable only to gifts made after December 31, 1942.

Powers of Appointment

The exercise or release (except a release prior to January 1, 1943) of a power of appointment is taxable as a transfer of property by the individual possessing such power. The term "power of appointment" means the same thing for gift tax purposes as for estate purposes. See page 41.

If such a power to appoint was created prior to the enactment of the 1942 Act and is not exercisable in favor of the donee of the power, his estate, his creditors, or the creditors of his estate, the amendment is not applicable unless the power is exercised after the enactment of the 1942 Act.

If such a power of appointment was created prior to the enactment of the 1942 Act and is exercisable in favor of the donee of the power, his estate, his creditors or the creditors of his estate, the amendment is not applicable until the expiration of six months after the termination of any legal disability to release such power (including service in the military or naval forces of the United States in the present war) existing on the date of the enactment of the 1942 Act.

Specific Exemption

The specific exemption is reduced from $40,000 to $30,000.

Period for Filing Petition With Tax Court

A petition to The Tax Court of the United States may be filed within 105 days after the mailing of the deficiency notice, if said notice is addressed to a donor outside the State of the Union and the District of Columbia.

Overpayment Found by Tax Court

In order that a refund of gift taxes found by The Tax Court of the United States may be made, the court must determine, as a part of its decision that the overpayment was made within three years of the filing of a claim or the mailing of the deficiency notice, whichever is the earlier (instead of within three years of the filing of the petition).

Situs of Stock of Domestic Corporation

The situs of stock in a domestic corporation owned and held by a nonresident alien is fixed as within the United States.

Community Property

All gifts of community property are taxable as gifts of the husband except to the extent that it is shown that such property was received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife.

The $3,000 Exclusion

The first $3,000 (instead of the first $4,000) of the total gifts to any

person during a calendar year is excluded from the total amounts of such gifts for such year. This exclusion is now extended to gifts made in trust.

Common Trust Funds

AMORTIZATION OF BOND PREMIUM

The election given to all taxpayers as to how amortizable bond premiums shall be taxed, in the case of bonds held by a common trust fund, is exercisable only by the common trust fund. The amendment is applicable to taxable years beginning after December 31, 1941.

If a common trust fund elects to treat the premium on bonds of the United States or instrumentalities thereof (other than a bond the interest on which is wholly exempt from tax, in which event amortization is compulsory) as amortizable, the credit allowed to each participant of a proportionate share of the interest on such bonds must be reduced by so much of the amortizable bond premium as is attributable to such share.

THE VICTORY TAX

The victory tax is applicable to participants in common trust funds. Any participant is required, in respect of his common trust fund income, to include in computing his victory tax net income, whether or not distributed or distributable, his proportionate share of the ordinary net income or the ordinary net loss of the common trust fund.

Tax Rates

By H. E. Bischoff
(New York Office)

The 1942 Revenue Act is the largest single tax levy in American history. Treasury experts estimate that more than 16,000,000 new income taxpayers will be added to the present 28,000,000 due chiefly to the reduction in exemptions and the introduction of the 5 per cent victory tax.

Income Tax on Individuals

The tax rates imposed by the Revenue Act of 1942 apply to taxable years beginning after December 31, 1941, except that individuals with fiscal years beginning in 1941 and ending after June 30, 1942, will be partly subject to 1942 rates (Section 140 of Revenue Act of 1942), and that the victory tax will apply to taxable years beginning after December 31, 1942.

Simplified Tax Schedule

An individual having a gross income of $3,000 or less derived from salary, wages, compensation for personal services, dividends, interest and annuities, and reporting on a cash basis for the calendar year, may elect to pay the optional tax at the rates imposed by Section 400 of the Code as revised by Section 104 of the 1942 Act. The status of a married person, head of family, and dependents is determined as of July 1 instead of at the end of the year, which was previously the case. The deduction from gross income for each dependent is $385. One spouse may not use the optional method if the other spouse uses the regular method.

Exemptions

The personal exemptions allowed citizens and residents have been reduced to the following amounts:

Single person or married person not living with spouse	$ 500
Married person living with spouse or head of family	1,200
Credit for dependents (each)	350

If a taxpayer would not qualify as "head of a family" except by reason of there being one or more dependents for whom a credit is allowable, the credit ($350) is not allowed with respect to one of such dependents.

An estate is allowed a personal exemption of $500, and a trust $100.

Normal Rate

The normal income tax rate has been increased from 4 to 6 per cent.

Surtax Rates

The surtax rates begin at 13 per cent on the first $2,000 of surtax net income and are graduated upward to 82 per cent on the excess over $200,000.

In the following table the last column shows the combined normal and surtax on the maximum amount of net income shown in each bracket:

RATES OF TAX ON INDIVIDUAL INCOMES
(Not including Victory Tax)

Taxable Net Income in Excess of Personal Exemption			*Surtax Rates (pct.)*	*Cumulative Surtax on Maximum Amount in Each Bracket*	*Combined Normal Tax (6%) and Surtax**
First		$ 2,000	13	$ 260	$ 380
2,000	to	4,000	16	580	820
4,000	to	6,000	20	980	1,340
6,000	to	8,000	24	1,460	1,940
8,000	to	10,000	28	2,020	2,620
10,000	to	12,000	32	2,660	3,380
12,000	to	14,000	36	3,380	4,220
14,000	to	16,000	40	4,180	5,140
16,000	to	18,000	43	5,040	6,120
18,000	to	20,000	46	5,960	7,160
20,000	to	22,000	49	6,940	8,260
22,000	to	26,000	52	9,020	10,580
26,000	to	32,000	55	12,320	14,240
32,000	to	38,000	58	15,800	18,080
38,000	to	44,000	61	19,460	22,100
44,000	to	50,000	63	23,240	26,240
50,000	to	60,000	66	29,840	33,440
60,000	to	70,000	69	36,740	40,940
70,000	to	80,000	72	43,940	48,740
80,000	to	90,000	75	51,440	56,840
90,000	to	100,000	77	59,140	65,140
100,000	to	150,000	79	98,640	107,640
150,000	to	200,000	81	139,140	151,140
Over		200,000	82		

*Before allowing credits for "Earned Income" or for interest on U. S. obligations, etc., allowed under section 25 of the Code.

Victory Tax

In addition to the normal tax and surtax a tax of 5 per cent is imposed on "victory tax net income" on individuals (other than nonresident aliens not engaged in business in the United States) having an annual gross income of more than $624, with respect to taxable years beginning after December 31, 1942. In general "victory tax net income" comprises gross income (excluding capital gains and certain interest) less expenses and other deductions described in Subchapter D.

The total of normal tax, surtax and victory tax is limited to 90 per cent of net taxable income.

In the case of employed persons the 5 per cent tax will be withheld at the source by the employer on all compensation in excess of $12 per week.

A post-war credit (refund after the war) is provided to the extent of 25 per cent of the victory tax (limited to $500) for single persons, 40 per cent (limited to $1,000) for married persons, and 2 per cent for each dependent (limited to $100 each).

Credits against the victory tax currently payable are allowed for the payment of life insurance premiums, liquidation of indebtedness and purchase of U. S. bonds. These credits may not exceed the post-war credit, and correspondingly reduce the refund to be made to the taxpayer after the war.

Income and Excess Profits Taxes on Corporations

The tax rates imposed by the 1942 Act apply to corporations with respect to taxable years beginning after December 31, 1941, except that corporations with fiscal years beginning in 1941 and ending after June 30, 1942 will be partly subject to 1942 rates.

Rates of Tax

The rates of normal tax, surtax and excess profits tax imposed on corporations (other than the special classes of corporations hereinafter referred to) are indicated in the three illustrative computations (Tables I, II and III) and the accompanying explanations which form part of the article beginning at page 1 of this issue. Consequently, those rates are not repeated at this point.

Regulated Investment Companies

These companies are exempt from the excess profits tax. They are taxed upon "Supplement Q net income" at the normal rate of 24 per cent, and in addition upon "Supplement Q surtax net income" at the rate of 16 per cent.

Surtax on Personal Holding Companies

These companies are also exempt from the excess profits tax. However, in addition to the regular corporation normal and surtax, a surtax upon their "undistributed Subchapter A net income" is imposed at the following rates:

Undistributed Subchapter A Net Income	*Rates of Surtax*
Not in excess of $2,000	75%
In excess of $2,000	85%

Surtax on Corporations Improperly Accumulating Surplus

This tax, which is in addition to the regular corporation normal, surtax and excess profits taxes, is computed on "undistributed Section 102 net income" of other than per-

sonal holding companies, and does not apply to income subject to excess profits tax. The rates of tax remain unchanged, as follows:

Undistributed Section 102 Net Income	*Rates of Surtax*
Not in excess of $100,000	27½%
In excess of $100,000	38½%

Foreign Corporations and Nonresident Alien Individuals

Resident Foreign Corporations Having U. S. Business

Foreign corporations engaged in trade or business in the United States are taxed on income from U. S. sources at the rate of 24 per cent, regardless of the amount thereof. They are also subject to the surtax under Section 15 at the rates previously outlined herein, except that Western Hemisphere Trade Corporations are exempt.

Nonresident Alien Individuals Having U. S. Business

The tax is based upon gross income from sources within the United States, less deductions applicable to such income, and less a personal exemption of $500 with certain exceptions applicable to residents of Canada and Mexico. The rates of normal tax and surtax on such income are the same as those in case of citizens.

Nonresident Foreign Corporations and Nonresident Alien Individuals Having No U. S. Business

In these cases the tax is to be withheld at the source under the conditions and at the rates shown in Sections 143 and 144 of the Code. The rate on fixed and determinable income in the United States, as described in Sections 211 and 231, has been increased from 27½ per cent to 30 per cent in the case of non-resident alien individuals and non-resident foreign corporations, the increased rate being applied to income received after October 30, 1942. If, however, such nonresident alien individuals have gross income of more than $15,400 from sources within the United States, they are subject to tax at the same normal and surtax rates as U. S. citizens on income for the entire year but not less than 30 per cent of gross income. In such case they are required to make returns, and to pay the excess of tax shown thereon over the tax which has been withheld at the source.

The above rates are not to apply if their application would violate any treaty obligation of the United States and may be reduced in pursuance of treaties relating to rates of tax on nonresident alien individuals resident in, and foreign corporations organized under the laws of, Western Hemisphere countries.

Under treaty with Canada the

maximum tax on nonresident aliens who are residents of Canada is 15 per cent.

Capital Stock Tax

The three-year system of adjusted declared value has been discontinued, and a new declaration of value of capital stock is now allowed each year, beginning with the year ended June 30, 1942.

The Commissioner has granted a general extension to November 28, 1942 for filing the return for the federal year ended June 30, 1942.

Rate of Tax: $1.25 for each $1,000 of declared value.

Gift Tax

The cumulative specific exemption of $40,000 and the $4,000 exclusion allowed on account of each donee for gifts, other than gifts in trust or of future interest in property, continue until December 31, 1942, and thereafter are $30,000 and $3,000, respectively. Also, the $3,000 exclusion from the total gifts to any one donee during a calendar year has been extended to gifts in trust made after December 31, 1942.

The rates of tax remain unchanged, as follows:

GIFT TAX RATES

Net Gifts (after deducting specific exemptions as described above)			*Rates of Tax (pct.)*	*Cumulative Tax on Maximum Amount of Each Bracket*
$ 0	to	$ 5,000	2¼	$ 112.50
5,000	to	10,000	5¼	375
10,000	to	20,000	8¼	1,200
20,000	to	30,000	10½	2,250
30,000	to	40,000	13½	3,600
40,000	to	50,000	16½	5,250
50,000	to	60,000	18¾	7,125
60,000	to	100,000	21	15,525
100,000	to	250,000	22½	49,275
250,000	to	500,000	24	109,275
500,000	to	750,000	26¼	174,900
750,000	to	1,000,000	27¾	244,275
1,000,000	to	1,250,000	29¼	317,400
1,250,000	to	1,500,000	31½	396,150
1,500,000	to	2,000,000	33¾	564,900
2,000,000	to	2,500,000	36¾	748,650
2,500,000	to	3,000,000	39¾	947,400
3,000,000	to	3,500,000	42	1,157,400
3,500,000	to	4,000,000	44¼	1,378,650
4,000,000	to	5,000,000	47¼	1,851,150
5,000,000	to	6,000,000	50¼	2,353,650
6,000,000	to	7,000,000	52½	2,878,650
7,000,000	to	8,000,000	54¾	3,426,150
8,000,000	to	10,000,000	57	4,566,150
Over		10,000,000	57¾	

Declared Value Excess-Profits Tax

The rates of tax remain unchanged as follows:

6.6 per cent of such portion of a corporation's net income (before deduction of declared value excess-profits tax), less the credit for dividends received, as is in excess of 10 per cent and not in excess of 15 per cent of the declared value at the close of its preceding income tax year, and

13.2 per cent of such portion of a corporation's net income as is in excess of 15 per cent of the declared value.

Excise Taxes

No attempt has been made to deal in this article with the various manufacturers' and retailers' excise, stamp, social security and other taxes included in the Code as amended by the Revenue Act of 1942. These taxes have become considerable in number and some of them are quite complex in respect of determination and administration. They need to be studied by each taxpayer in the light of his business and attendant circumstances, so that he may decide to which of them he is subject.

Estate Tax

The basic rates (Section 810) and the rates for computing the additional tax (Section 935) applying to estates of decedents dying on and after September 21, 1941 have not been changed by the Revenue Act of 1942.

Exemption

The specific exemption of $100,000 for computing the tax under Section 810 remains the same, but the specific exemption of $40,000 for computing the additional estate tax under Section 935 has been increased to $60,000 (and the $40,000 insurance exclusion has been repealed) in the case of decedents dying after October 21, 1942.

Method of Computation

Two separate computations are required in order to arrive at the total estate tax, namely: (1) using an exemption of $100,000 and the tax rates under Section 810 for the purpose of arriving at a base for computing the maximum credit (80 per cent of such base) for inheritance and estate taxes paid to any state, territory, the District of Columbia or any possession of the United States, and (2) using an exemption of $40,000 or $60,000 in the case of decedents dying after October 21, 1942, and the rates under Section 935, from which there is deducted the tax under Section 810 (before deducting from the latter the credit for state tax). The amount remaining after deducting from (1) the credit for state inheritance and estate taxes is added to (2) to arrive at the total tax.

The schedule of rates follows, the amount of tax shown being that applicable to the maximum amount of net estate falling in each bracket.

ESTATE TAX RATES

Value of Net Estate (after deducting exemptions as described above)	Tax Under Section 810 Rates of Tax (pct.)	Tax Under Section 810 Amounts of Tax	Tax Under Section 935 Rates of Tax (pct.)	Tax Under Section 935 Amounts of Tax
$ 0 to $ 5,000	1	$ 50	3	$ 150
5,000 to 10,000	1	100	7	500
10,000 to 20,000	1	200	11	1,600
20,000 to 30,000	1	300	14	3,000
30,000 to 40,000	1	400	18	4,800
40,000 to 50,000	1	500	22	7,000
50,000 to 60,000	2	700	25	9,500
60,000 to 70,000	2	900	28	12,300
70,000 to 100,000	2	1,500	28	20,700
100,000 to 200,000	3	4,500	30	50,700
200,000 to 250,000	4	6,500	30	65,700
250,000 to 400,000	4	12,500	32	113,700
400,000 to 500,000	5	17,500	32	145,700
500,000 to 600,000	5	22,500	35	180,700
600,000 to 750,000	6	31,500	35	233,200
750,000 to 800,000	6	34,500	37	251,700
800,000 to 1,000,000	7	48,500	37	325,700
1,000,000 to 1,250,000	8	68,500	39	423,200
1,250,000 to 1,500,000	8	88,500	42	528,200
1,500,000 to 2,000,000	9	133,500	45	753,200
2,000,000 to 2,500,000	10	183,500	49	998,200
2,500,000 to 3,000,000	11	238,500	53	1,263,200
3,000,000 to 3,500,000	12	298,500	56	1,543,200
3,500,000 to 4,000,000	13	363,500	59	1,838,200
4,000,000 to 4,500,000	14	433,500	63	2,153,200
4,500,000 to 5,000,000	14	503,500	63	2,468,200
5,000,000 to 6,000,000	15	653,500	67	3,138,200
6,000,000 to 7,000,000	16	813,500	70	3,838,200
7,000,000 to 8,000,000	17	983,500	73	4,568,200
8,000,000 to 9,000,000	18	1,163,500	76	5,328,200
9,000,000 to 10,000,000	19	1,353,500	76	6,088,200
Over 10,000,000	20		77	

Notes

The following members of the staff have entered the country's military service since the publication of the September issue of the L. R. B. & M. JOURNAL:

Chicago:
Allen J. Gerken
George B. Vasen

Cincinnati:
Floyd Kolb

Dallas:
Leon E. Smith

Detroit:
Stanley G. Janson

New York:
Dante Caimi
Henry C. Elfers
Robert L. Hartlieb
Fred W. Hunold
Owen W. Jaeger
Felix W. Konkle
Harold J. McDonald
Wilfrid C. McLaughlin, Jr.
Paul F. Mason
Henry S. Sekerak
Edward J. Taylor
Irving R. Warshow

Philadelphia:
John S. Baxter
Walter S. Bernheimer
Donald H. Grim
Lloyd S. Mortimer
Charles C. Ross
Louis J. Stow

Pittsburgh:
James Grier Marks, Jr.

Rockford:
Joseph Garrity

San Francisco:
William S. Mitchell, Jr.

Mr. Russell served as Chairman of the Michigan Accounting Conference which was held in the Rackham Memorial Building, Detroit, Michigan, on November 7. This conference was sponsored jointly by the Michigan Association of Certified Public Accountants and the School of Business Administration of the University of Michigan.

Mr. Edward J. Barr, of our Detroit office, was one of the speakers at the conference. The subject of his paper was Termination Problems Under War Contracts.

A. R. Kassander, of our New York staff, addressed the Reading (Pa.) Chapter of the National Association of Cost Accountants on September 18 on the subject of "Installation of an Operating Budget."

On October 15th he spoke to the Bridgeport (Conn.) Chapter of the N. A. C. A. on "Auditing and/or Accounting for Government Contracts."

The meeting is stated to have been the largest held by the Bridgeport Chapter this year. The report of the meeting by the National Secretary, which appeared in the N. A. C. A. Bulletin of November 15, included the following paragraphs regarding Mr. Lybrand's attendance at the meeting:

I had a lovely time in Bridgeport the other night. It might have been one of the most dramatic meetings in the history of the Association, but our dear old friend Dick Foster likes to do things in his own quiet and efficient normal way. Our senior Past President, Mr. Lybrand, was the guest chairman, and in the audience we had J. F. D. (John) Rohrbach who was Major Nicholson's partner at the time our Association was formed and who has always taken a deep personal interest in its development. He is now assistant to the President of Raybestos. Mr. Warner, our National Treasurer, also was there and, as you know, it was in the offices of his company that the first office of N. A. C. A. was established in 1919. It was a very interesting occasion and a large and successful meeting . . .

Dick Foster paid me the high compliment of asking me to introduce Mr. Lybrand, which was one of the most intriguing assignments I have ever had. I had introduced Mr. Lybrand in Bridgeport twenty years before. At that time we had no chapter in Bridgeport but there was an excellent organization known as the Bridgeport Cost Forum which was operated by the Manufacturers' Association under the direction of Alpheus Winter. It had been suggested that we might establish a chapter of our Association in Bridgeport, but we felt that it would not be advisable to do so unless we could combine with the Cost Forum. Relations between the two organizations were very friendly but the Cost Forum was justly proud of its accomplishments and they hesitated to submerge their identity with N. A. C. A. The purpose of the meeting was to discuss the possibility of an amalgamation.

Mr. Lybrand was President of our Association at the time and I introduced him. The amalgamation of the two organizations did not take place until almost ten years later, but possibly foundations of mutual respect may have been created on that occasion. In any event, some ten years later through the joint efforts of Alpheus Winter and Joe Coburn the Bridgeport Chapter was created and Alpheus Winter has always been one of our staunch friends. In order to make the picture complete, he was with us the other night. Possibly these personal relationships from years long gone loom more largely in our evaluations as we have deeper vistas through which to survey them, but I must confess at the risk of seeming sentimental that I had a choke in my voice as I went back across those years and viewed today this splendid chapter based upon the unselfish and constructive thinking of many men who are still participating in its growth and development.

During October, Mr. A. J. Fowler, formerly of the staff of Messrs. Pattrick, Feist & Jack, chartered accountants in New Zealand, called on us with a letter of introduction from Mr. P. E. Pattrick, whom our firm has known for the past twenty years. Mr. Fowler was accompanied by Mr. Appleby, both of them being members of the Royal New Zealand Air Force in training somewhere in Canada. Mr. Sinclair acted as their host and was able to have them meet that sterling New Zealander and erstwhile member of our staff, Mr. Gordon C. Cooke, now President of the D. L. & W. Coal Company, with whom they spent a part of their weekend visit to New York.

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